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November 16, 2021

Via E-mail

Securities and Exchange Commission,
100 F Street NE,
Washington, DC 20549-1090.

Attention: Vanessa A. Countryman, Secretary

Re: Reopening of Comment Period for Listing Standards for Recovery
of Erroneously Awarded Compensation – File No. S7-12-15

Ladies and Gentlemen:

We appreciate the reopening by the Securities and Exchange Commission (the “Commission”) of the comment period for the Commission’s previously proposed listing standards for the recovery of erroneously awarded compensation as provided by Section 954 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the “Dodd-Frank Act”).¹ We believe that the reopening is appropriate in light of the lapse of time since the original proposal in 2015² and appreciate the opportunity to respond to a specific question raised by the Commission in the 2021 Release.

The Commission specifically requested comment on whether the scope of its proposed rule and rule amendments should be expanded to include not only “restatements that correct errors that are material to previously issued financial statements,” but also “restatements that correct errors that are not material to previously issued financial statements, but would result in a material misstatement if (a) the errors were left uncorrected in the current report or (b) the error correction was recognized in the current period.” We do not believe that the proposed expansion of the definition of “restatement” is consistent with Section 954, with relevant accounting guidance on “restatements” or with the commonly understood meaning of “restatement.”

¹ Reopening of Comment Period for Listing Standards for Recovery of Erroneously Awarded Compensation, Release Nos. 33-10998; 34-93311 (Oct. 14, 2021) [86 FR 58232 (Oct. 21, 2021)] (the “2021 Release”). Section 954 of the Dodd-Frank Act added Section 10D to the Securities Exchange Act of 1934 (the “Exchange Act”).

² Listing Standards for Recovery of Erroneously Awarded Compensation, Release Nos. 33-9861; 34-75342 (Jul. 1, 2015) [80 FR 41143 (Jul. 14, 2015)] (the “Proposing Release”).

Consistent with the text of Section 10D of the Exchange Act, proposed Rule 10D-1 (the “Proposed Rule”) would require listed issuers to implement policies providing for the recovery of erroneously awarded incentive-based compensation “in the event that the issuer is required to prepare an accounting restatement due to the material noncompliance of the issuer with any financial reporting requirement under the securities laws.” The Proposed Rule defines “accounting restatement” as “the result of the process of revising previously issued financial statements to reflect the correction of one or more errors that are material to those financial statements.” Under the Proposed Rule, for the purposes of Section 10D, “a restatement to correct an error that is material to previously issued financial statements shall be deemed to result from material noncompliance of the issuer with a financial reporting requirement under the securities laws.” The Proposed Rule’s implementation of Section 10D with these two definitions is consistent with the Commission’s view expressed in the Proposing Release that “an error that is material to previously issued financial statements constitutes ‘material noncompliance’ by the issuer with a financial reporting requirement under the securities laws, as contemplated by Section 10D.”

As noted above, the interpretation of the term “accounting restatement due to material noncompliance” now being considered by the Commission would include “(1) restatements that correct errors that are material to previously issued financial statements and (2) restatements that correct errors that are not material to previously issued financial statements, but would result in a material misstatement if (a) the errors were left uncorrected in the current report or (b) the error correction was recognized in the current period.” While not entirely clear, it appears from clause (2) that the Commission is proposing that an error correction in the current period could be deemed “an accounting restatement due to material noncompliance.” However, an error can only be corrected in the current period if that error is immaterial to the previously issued financial statements.³ A material error in previously issued financial statements, by contrast, requires the restatement of those financial statements by filing an amendment.⁴ An error that can be corrected in the current period would, by definition, not constitute “material noncompliance” because a material error with respect to a historical period cannot be corrected in the current period. As a result, an issuer correcting errors in the current period cannot be said to be required to prepare an accounting restatement; a restatement, by definition, refers to previously issued financial statements. Corrections made in a current period are not a “restatement” of the current period.

³ Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (Sep. 13, 2006).

⁴ *Id.*

The Commission is “considering whether it would be more appropriate to rely on existing guidance, literature and definitions concerning accounting errors rather than define ‘accounting restatement’ and ‘material noncompliance.’” We agree that this is the appropriate approach and consistent with Item 4.02(a) of Form 8-K. It seems that for the same reasons Item 4.02(a) incorporates accounting guidance, the new rule should as well.⁵

It is important, in our view, to have consistency in the application and interpretation of Commission rules. In our view, the Commission should use the same standard as Item 4.02(a), which at this point is well understood and has been utilized on many occasions. To use a different standard would inject uncertainty into how the new rule operates and create confusion. We note also that Section 954 was adopted against the backdrop of the existing requirements of Item 4.02(a) and there is no reason to believe Congress intended for a different interpretation of restatement.⁶ Finally, the standard of materiality with respect to errors in financial statements has been well-developed by the staff of the Commission and over more than twenty years of practice to be aligned with both accounting literature and the formulation used by courts in interpreting federal securities laws, and to take into account both quantitative and qualitative factors.⁷

In light of the foregoing, we respectfully request that the Commission reevaluate its proposed interpretation of “an accounting restatement due to material noncompliance” and clarify that it only encompasses those restatements requiring Item 4.02(a) filings.

* * *

⁵ See Final Rule: Additional Form 8-K Disclosure Requirements and Acceleration of Filing Date, Release Nos. 33-8400; 34-49424 (Mar. 16, 2004); Technical Amendments to Commission Rules and Forms Related to the FASB’s Accounting Standards Codification, Release Nos. 33-9250; 34-65052 (Aug. 8, 2011).

⁶ See Report of the Senate Committee on Banking, Housing, and Urban Affairs, S.3217, Report No. 111-176 at 135–36 (Apr. 30, 2010) (“Section 954 requires public companies to have a policy to recover money that they erroneously paid in incentive compensation to executives as a result of material noncompliance with *accounting rules*.”) (emphasis added).

⁷ See Staff Accounting Bulletin No. 99, *Materiality* (Aug. 12, 1999).

We note the statement in the 2021 Release that “[a]ll comments received to date on the Proposed Rules will be considered and need not be resubmitted” and therefore are not resubmitting any of the comments in our September 22, 2015 letter commenting on the proposal. We note however, that nothing that has taken place in the more than six years since those comments were submitted has affected our views on any of the four comments provided in our prior letter: (1) The Proposed Rule intrudes on non-US governance authority and standards and is inconsistent with fundamental principles of international comity; (2) The Final Rule should afford issuers (and their boards of directors) greater discretion when making clawback determinations; (3) Using the Rule 16a-1(f) definition of “executive officer” subjects a wide range of individuals to the Proposed Rule’s no-fault recovery mandate, when such persons may have limited responsibility for the issuer’s financial reporting; and (4) The Proposed Rule’s three-year clawback period is overly formulaic and may discourage individuals from serving in interim service in executive officer roles.

We also reiterate our view, noted as part of a letter from 40 law firms submitted on October 28, 2021, that the comment period should be extended given the potential of significantly broadening the scope of the Proposed Rule.

* * *

We would be happy to discuss any questions with respect to this letter or our September 22, 2015 letter. Any such questions may be directed to Robert W. Reeder, III [REDACTED] or Marc R. Trevino [REDACTED].

Sincerely,

A handwritten signature in blue ink that reads "Sullivan & Cromwell" followed by a stylized monogram "SC".

SULLIVAN & CROMWELL LLP